Commission has set forth Part 32 accounting procedures whereby the LEC will credit regulated revenues and the corresponding debit entry will be made to other nonregulated revenues.[48] Given this treatment. there is no need for complicated changes in cost pools and allocations, as put forth in the NPRM (¶ 56). Such NPRM proposals confuse a pricing/imputation requirement of the Act with Part 64 cost allocation. There is no need to address pole attachment imputations to regulated activities in this proceeding.

Accordingly, consistent with the intent of Section 224(g), the Commission's rules provide for evenhanded treatment of LEC and nonaffiliates with respect to their provision of nonregulated services, and do not require change here.

## IV. THERE IS NO BASIS FOR EXPANDING THE TYPES OF COST REALLOCATIONS FROM REGULATED TO NONREGULATED ACTIVITIES SUBJECT TO EXOGENOUS TREATMENT

The NPRM (at ¶ 60 & n. 68) refers to Section 61.45(d)(1)(v) of the Commission's rules, which makes eligible for exogenous treatment under price cap regulation: "[t]he reallocation of investment from regulated to nonregulated activities pursuant to § 64.901...." The Commission invites comment on whether all reallocations to nonregulated activities that may result from the offering of

48 See Joint Cost Further Reconsideration Order, ¶¶ 2-3, 15. A LEC nonregulated affiliate would likely record the charge for pole attachments, etc., within expense accounts.

video programming services or other nonregulated activities should trigger decreases in related price cap indices.[49]

The FCC has previously made clear that its Rule 61.45(d)(1)(v) on exogenous treatment of investment reallocations from regulated to nonregulated, is narrow in scope. That rule only applies to the situation where, pursuant to Rule 64.901(b)(4),[50] joint network plant is allocated using the forward-looking peak nonregulated usage allocator; actual nonregulated usage turns out to exceed the projected forward-looking peak usage; and the carrier makes the required reallocation of network investment from regulated to nonregulated.[51]

In reference to the NPRM, ¶ 60, there is no basis for expanding the types of cost reallocations from regulated to nonregulated to be given exogenous treatment, for three reasons. First, such action would probably result in a double-count under the price cap formula, which would harm LEC investors. In its X-Factor NPRM proceeding,[52] the Commission is considering adopting a moving average, Total Factor Productivity-based X-Factor (productivity offset) which "would recognize almost all of the costs for which exogenous treatment would

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49 NPRM, ¶ 60.

50 See also Joint Cost Reconsideration Order, ¶¶ 16-17, 28-41.

51 See LEC Price Cap Order, CC Docket No. 87-313, 5 FCC Rcd 6786, ¶¶ 171-72 (1990); Policy And Rules Concerning Rates For Dominant Carriers, CC Docket No. 87-313, 4 FCC Rcd 2873, ¶¶ 300-02 (1989); Annual 1991 Access Tariff Filings, Transmittal No. 452, 6 FCC Rcd 3792, ¶¶ 49-54 & n. 23 (1991)(Common Carrier Bureau rejected MCI broad argument for exogenous treatment of nonregulated cost shifts for investments or expenses).

52 CC Docket No. 94-1, released September 27, 1995.

now be accorded, leaving exogenous cost treatment requests only to cost changes which are truly unique to individual LECs."[53] The FCC's ongoing price cap performance review has been focused on the X-Factor to ensure it continues to capture LEC productivity, including efficiency growth from new investment. The proposed X-Factor in the LEC price cap formula is designed to capture total company productivity growth, including nonregulated activities, provided on an integrated basis with regulated activities.[54] Under the Christensen Moving Average Total Factor Productivity ("TFP") methodology sponsored by USTA in the X-Factor NPRM proceeding, and supported by NYNEX, ongoing productivity enhancements and growth in such total company activities, including new investments, will be captured. Thus, for example, it would be duplicative to apply such an X-Factor plus make an exogenous cost adjustment for all cost reallocations from regulated to nonregulated.

Second, the Commission has changed its price cap rules on a going-forward basis to deny exogenous treatment of certain accounting rule changes which result in only a change in how books are kept and costs are recorded, not a change in economic cash flow.[55] Expansion of exogenous treatment of cost

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[53] See LEC Price Cap Performance Review Order, ¶ 292; X-Factor NPRM, ¶¶ 138-41.

[54] See Christensen Study, as cited in X-Factor NPRM at ¶¶ 22-25; Revised Christensen Study, appended to NYNEX Comments filed January 11, 1996 in response to X-Factor NPRM.

[55] See LEC Price Cap Performance Review Order, ¶¶ 293-309; Bell Atlantic Telephone Companies v. FCC, No. 95-1217, Decision issued March 29, 1996, p. 16.

reallocations from regulated to nonregulated would appear inconsistent with that new rule, since Part 64 changes can be considered accounting rule changes,[56] and such changes would be noneconomic in nature and not impact carriers' discounted cash flow.

Third, additional downward exogenous changes in respect of cost reallocations would undercut LECs' incentive to engage in integrated nonregulated activities which would otherwise benefit the telephone ratepayer.[57] As noted earlier, embedded telephone plant is not equipped for new video programming service offerings. The threat of artificial reallocations of such plant costs to nonregulated would hamper LEC procompetitive efforts. In the case of new investments to be made, there should be no exogenous cost issue at all, since there are no existing costs to reallocate. In no event should LECs be penalized for new investments. In addition, even if downward adjustments were made, and interstate access rates reduced, there is no assurance interexchange carriers would pass through such reductions to consumers.

## V. CONCLUSION

The Commission should waive or forbear from applying Part 64 rules in the price cap environment. To the extent Part 64 is retained, it should be streamlined. The Commission should prescribe guidelines that provide for direct

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56 See Joint Cost Order, ¶ 90.

57 See NPRM, ¶ 62.

assignment and cost-causative allocations, as opposed to arbitrary allocations that would deter LEC nonregulated, procompetitive offerings benefiting telephone ratepayers. With respect to reallocation of costs from regulated to nonregulated, no change in exogenous cost rules is warranted in this proceeding.

Respectfully submitted,

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